

Internal Revenue Service

Department of the Treasury

NO POSTAGE
NECESSARY
IF MAILED
IN THE
UNITED STATES
3-31-97

C 20224

Inc.

Person to Contact:

Telephone Number:

Refer Reply to:

Date: FEB 20 1997

Employer Identification Number:

Key District:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) of the Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

The information provided indicates that you () were incorporated under the laws of () in (). Your Articles of Incorporation provide that the () was formed exclusively for charitable and educational purposes, "including without limitation general health counseling," the () incorporators were ().

The Center's current Board of Directors and officers are as follows:

The Board is self-perpetuating. () are related by marriage.

The Center subleases real property from () and rents offices within its facilities to independent "holistic" health practitioners. Rent paid by the independent practitioners includes cleaning services, utilities, parking, "miscellaneous supplies," and a central telephone.

Practitioners currently renting office space at the center are as follows:

[REDACTED]

[REDACTED]

These individuals are engaged in the practice of various holistic health specialties including the following:

- Holistic Psychotherapy
- Bodywork and Massage Therapy
- Hands-On Healing
- Craniosacral Therapy
- Imagery and Meditation
- Kinesiology
- Homeopathic Remedies

In addition to individual counseling, the practitioners offer group workshops, educational classes, and support groups. Fees for services provided at the center are set by each individual practitioner.

Practitioners pay the [REDACTED] 10% of the gross receipts derived the use of common areas for workshops and classes. In addition, a one-time fee is paid by practitioners for each new client referred to the practitioner by the [REDACTED]

The [REDACTED] plans to negotiate for the provision of services by the practitioners at a reduced fee. The [REDACTED] will underwrite a portion of the costs of the services provided to individuals who cannot afford them. Each practitioner will adjust his or her fees for clients who cannot pay full fee for services. The [REDACTED] proposes to pay 50% of the difference between the negotiated fee and the standard set fee.

Substantially all of the [REDACTED] current revenue has been derived from the practitioners. It is anticipated that future funding will also be provided by donations, fund raising events, membership fees, and the sale of "gift certificates." The gift certificates are essentially a prepayment for services to be provided to a designated individual. When the certificate is redeemed, the [REDACTED] retains a portion of the purchase price and pays the remaining amount to the practitioner who provided the service.

The [REDACTED] major expenses will be for rent, utilities, maintenance, advertising, salaries, and employee benefits.

Section 501(a) of the Code provides for the exemption from federal income tax of organizations described in section 501(c)(3) of the Code.

Section 501(c)(3) of the Code provides, in part, for the exemption of organizations that are organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and is not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax exempt purposes which may fall within the broad outlines of charity as developed by judicial decisions. In the general law of charity, the promotion of health has traditionally been considered a charitable purpose. See Restatement (Second) of Trusts, 368, 372 (1959).

Rev. Rul. 67-5, 1967-1 C.B. 123, concerned a foundation controlled by its creator's family and operated to enable the creator and his family to engage in financial activities which are beneficial to them, but detrimental to the foundation. The Service concluded that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. The ruling reasoned as follows:

"The use of the foundation as a vehicle for activities advantageous to its creator and his family and as a source of funds to finance such activities, the resulting investments by the foundation in assets that fail to produce income for a charitable program commensurate in scope with its financial resources, the continued failure of its trustees to protect the value of these investments, and their failure to make them income-producing, all establish

[REDACTED]

that the foundation is operated for a non-exempt purpose, substantial in nature. That purpose is to serve the private financial interests of its creator and his family. . . . Furthermore, the foundation fails to serve a public, rather than a private, interest and therefore is not operated exclusively for charitable purposes."

Thus the foundation was not entitled to exemption under section 501(c)(3) of the Code.

In Rev. Rul. 69-266, 1969-1 C.B. 151, a medical doctor created an organization which he controlled. The organization then employed the doctor to conduct "medical research" which consisted of the doctor treating his patients on a fee for service basis. The ruling holds that the organization is not entitled to exemption under section 501(c)(3) because it served the doctor's private interest.

Est of Hawaii v. CIR, 71 T.C. 1067 (1979), aff'd in an unpublished opinion, 647 F. 2d 170 (9th Cir. 1981), held that an organization that was essentially controlled by a separate for-profit commercial entity was operated for a substantial non-exempt purpose where it promoted a certain body of knowledge, which was owned by that commercial entity. Whether the agreements between the parties reflected arm's length negotiation was irrelevant to the analysis. The court noted that the commercial entity was trading on the organization's tax-exempt status.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), aff'g T.C. Memo. 1984-349, the court upheld denial of 501(c)(3) status to an organization because it operated for the non-exempt purpose of providing a market for the services of a for-profit firm owned by parties related to the organization. Key facts considered by the court included that employees of the for-profit firm devoted two-thirds of their time to the organization's business; that the majority of the organization's income went to payments to the for-profit firm; and that the controlling parties profited from the relationship. The court rejected the organization's argument that the crucial inquiry was the reasonableness of the contracts involved, saying that the "critical inquiry" was instead "whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church," 765 F.2d at 1392 (citing Est of Hawaii, supra).

Similarly, in Housing Pioneers, Inc. v. Commissioner, 49 F.3d 1395 (9th Cir. 1995), aff'g, T.C. Memo. 1993-120, an organization was denied tax-exempt status under section 501(c)(3)

[REDACTED]

of the Code where it proposed to lend its tax-exempt status to for-profit commercial businesses. The organization would serve as co-general partner in limited partnerships to own and operate low income housing projects; operational control of the housing projects rested with the other general partner, a commercial entity. California law provided property tax benefits to housing projects owned by qualified non-profit corporations (or by partnerships in which a qualified non-profit corporation served as general partner). The Tax Court held that by serving as general partner, the organization had a substantial non-exempt purpose of benefiting private parties through reduction of property taxes on properties owned by the partnerships. The organization evidenced a non-exempt purpose of benefiting private parties by agreeing to ensure that the properties qualified for a tax credit under section 42 of the Code.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36 (1989), the court concluded that the petitioner was not described in section 501(c)(3) of the Code. The petitioner was organized to provide continuing medical education to physicians and took physicians on three-week tours throughout the world. It shared offices with a for-profit travel agency which was controlled by its principal officer. It made all its travel arrangements through the agency. The court found that a substantial purpose of the petitioner was benefitting the for-profit travel agency. The court concluded that "when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of [section] 501(c)(3), even if it furthers other exempt purposes."

In Airlie Foundation, Inc. v. United States, 95-1 U.S.T.C. ¶50,279 (1995), aff'g, 93-1 U.S.T.C. ¶50,355, the court upheld the Service's revocation of the organization's exemption. The Service had revoked its exemption on the grounds that it was serving the private interest of one of its directors. The conclusion rested on the director's control over a network of organizations that were involved in numerous transactions and exchanges allegedly for fair market value. Stating that a potential for abuse exists when the founder of an exempt organization also controls other non-exempt entities and those entities interact, the court agreed with the Service that the director was able to manipulate the funds and assets of the exempt organization and use its exempt status to benefit the nonexempt entities and himself.

In Better Business Bureau v. U.S., 326 U.S. 279 (1945), the Supreme Court of the United States held that the presence of a

[REDACTED]

single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

Your activities, in providing facilities for the provision of holistic health care services and negotiating fees for such services, as well as promoting and marketing those services, may, in fact, improve access to and utilization of holistic health care remedies. However, you do not directly provide health care services. Your chief function is to serve as an intermediary and facilitator between the practitioners and the community. Thus, your activities primarily serve the private interests of the individual practitioners. This characteristic is incompatible with the requirement of section 1.501(c)(3)-1(d)(ii) of the regulations that an organization must serve a public rather than a private interest to qualify under section 501(c)(3) of the Code.

Moreover, like the organizations described in the Revenue Rulings and court cases cited above, the [REDACTED] was established as a vehicle for activities advantageous to its creators and as a source of funds to finance such activities, and continues to be controlled by its creators. These facts establish that the [REDACTED] is operated for a non-exempt purpose, substantial in nature. That purpose is to serve the private financial interests of its creators and of the other holistic health practitioners.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2)

[REDACTED]

of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
Attn: CP:E:EO:T:3
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

[REDACTED]